

FINAL REPORT ON REVIEW  
OF CONTROLS OVER REFUNDS  
OF HARBOR MAINTENANCE  
TAX ON EXPORTS

OIG-00-016

February 7, 2000



Office of Inspector General

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United States Department of the Treasury



OFFICE OF  
INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

February 7, 2000

MEMORANDUM FOR COMMISSIONER RAYMOND KELLY  
UNITED STATES CUSTOMS SERVICE

FROM: Dennis S. Schindel *Dennis S. Schindel*  
Assistant Inspector General for Audit

SUBJECT: Final Report on Review of Controls Over  
Refunds of Harbor Maintenance Tax on Exports

This memorandum transmits our final report on *Review of Controls Over Refunds of Harbor Maintenance Tax on Exports*. The review was conducted as an addition to the Office of Inspector General's *Office of Audit Annual Plan for Fiscal Year 1999*, issued October 1, 1998. The objectives of the review were to evaluate whether the U.S. Customs Service (Customs) had: (1) established adequate controls over refunds of harbor maintenance tax on exports, and (2) complied with the U.S. Court of International Trade's (CIT) court order governing such refunds.

Our review disclosed that, overall, Customs had put in place adequate controls over refunds of harbor maintenance tax on exports. Our review did not identify any significant instances of non-compliance with the CIT's court order. We identified no significant areas needing improvement relating to the refund process; therefore, we make no recommendations. As such, no formal response to this report is required.

We appreciate the courtesies and cooperation provided to our staff during the review. If you wish to discuss this report, you may contact me at (202) 927-5400, or a member of your staff may contact Thomas A. Moschetto, Director, Financial Management Audits at (202) 927-5074.

Attachment

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## Overview

This report presents the results of our review related to refunds of unconstitutionally collected harbor maintenance tax (HMT) on exports. The review was conducted as an addition to the Office of Inspector General's *Office of Audit Annual Plan for Fiscal Year 1999*, issued October 1, 1998. Our review objectives were to evaluate whether the U.S. Customs Service (Customs) (1) had put in place adequate controls over refunds of HMT on exports, and (2) complied with the U.S. Court of International Trade's court order governing such refunds. Our objectives were not to opine on the adequacy of Customs' internal controls over the refund process or its compliance with the court order.

Our review disclosed that, overall, Customs' refund procedures were adequate. Also, no significant instances of non-compliance with the court order were identified. We discussed the contents of this report with appropriate Customs personnel and contractor management. We incorporated their comments in this report, as applicable. Also, we identified no areas where the refund process needed improvement; thus, we make no recommendations. Accordingly, no formal response to this report is required.

## Background

The Harbor Maintenance Revenue Act of 1986<sup>1</sup> established an HMT, effective April 1, 1987, which was assessed on: (1) imported, exported, and domestically shipped waterborne cargo; (2) foreign trade zone admissions, and (3) arriving passengers aboard commercial vessels. The HMT was initially 0.04 percent of the value of commercial cargo<sup>2</sup> loaded onto or unloaded from commercial vessels at U.S. ports. Effective January 1, 1991, the HMT increased to a rate of 0.125 percent of cargo value.

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<sup>1</sup>The Harbor Maintenance Revenue Act of 1986 was enacted November 17, 1986, under Title XIV of the Water Resources Development Act of 1986, Public Law 99-662, and amended Chapter 36 of the Internal Revenue Code of 1954 (relating to certain other excise taxes).

<sup>2</sup>Under the Harbor Maintenance Revenue Act, the term "commercial cargo" includes passengers transported for compensation or hire, e.g., cruise ships.

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In September 1994, the United States Shoe Corporation (U.S. Shoe) filed suit to challenge the constitutionality of the HMT on exports. The U.S. Department of Justice (Justice) represented the U.S. Government (Government) in the various court actions that followed based on U.S. Shoe's filing. The U.S. Court of International Trade (CIT), the U.S. Court of Appeals of the Federal Circuit, and the U.S. Supreme Court all held that the HMT on exports was unconstitutional. The U.S. Supreme Court also held that the CIT was the proper jurisdiction over controversies regarding HMT administration and enforcement. The U.S. Supreme Court rendered its decision on March 31, 1998.

On August 28, 1998, the CIT issued a court order, which required the Government to refund immediately the HMT on exports. HMT export payments eligible for refund included those payments received by Customs starting two years prior to a plaintiff's filing of a complaint with the CIT to recover such payments. During the period September 1992 through April 1998, Customs collected \$1.1 billion related to the export HMT.

The court order required each plaintiff to complete a "Harbor Maintenance Tax Refund Claim Form" (claim form), attach the filed complaint or complaints, and return it to Customs by October 15, 1998. Customs was to process those claim forms in chronological order by date of filing of plaintiff's first complaint, and to process claim forms received after October 15, 1998, in order of receipt. The court order established no filing cut-off date. As such, Customs continues to receive claim forms; however, the number is minimal. Review of the May 1999 through September 1999 status reports disclosed that Customs received only 27 new claims since the May reporting period.

The court order also established a three-phase claims process. In that regard, Customs was to perform the initial processing of claims (Phase I). Part of the process included sending to each plaintiff<sup>3</sup> a

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<sup>3</sup>The Government and co-counsels for the plaintiffs agreed that payment report and certification forms and payments would be sent to the attorney-of-record for each respective plaintiff. However, we do not make this definitive distinction, since the ultimate responsibility for the correctness of the refund or for providing supporting documentation on disputed payments rests with the plaintiff and not the plaintiff's attorney.

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"Harbor Maintenance Tax Payment Report and Certification" form (payment report and certification form) listing all payments by the plaintiff which were eligible for refund. The plaintiff was to review the listing and, if satisfied, fill out and sign a judgment form with the certification attached, and send it to Justice. Justice was to sign and file the proposed judgment with the CIT for entry of judgment.<sup>4</sup> Once the CIT entered judgment, Justice would forward a copy of the approved judgment to Customs to process for payment. The court order required Phase I to start as soon after October 15, 1998, as Customs arranged the claim forms by plaintiffs' first complaint filing date.

In Phase II, which began March 15, 1999, plaintiffs could dispute payments verified during Phase I. For example, a disputed payment would be one not listed on the payment report and certification form. In that instance, plaintiffs were to send appropriate supporting documentation to Customs. Customs was to search its database and original documentation to resolve the dispute, then send the plaintiffs a revised payment report and certification form within 60 days. Claims not resolved under Phase I or Phase II would be resolved under Phase III (judicial review).

Under the court order, Customs was to process court-approved judgments so payment could be made within 30 days of approval. Also, Customs was to process no fewer than 500 claims per month after December 15, 1998. Furthermore, Customs was to report on its claims processing progress monthly to the CIT starting November 15, 1998, and the 15th of every month thereafter.

Customs hired a contractor to help accomplish the task of (1) developing and implementing refund procedures, and (2) processing the claims. The contractor developed a stand-alone HMT database that contained HMT payment and refund data downloaded from Customs' Automated Commercial System. The contractor, in concert with Customs, also developed procedures to process the

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<sup>4</sup>"Entry of judgement" refers to a submission seeking the court's approval of the proposed judgment. Once the judgment is approved and entered onto the court's docket, it then becomes an "entered judgment."

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claims. The contractor hired temporary personnel<sup>5</sup> to perform payment searches and generate the payment report and certification form listing all HMT export payments identified from the HMT database. The contractor also assisted Customs in preparing the required status reports.

## **Objectives, Scope, and Methodology**

Our review objectives were to evaluate whether: (1) Customs had put in place adequate controls over refunds of HMT on exports, and (2) Customs' refund procedures complied with the CIT's court order governing such refunds. Our objectives were not to opine on the adequacy of Customs' internal controls over the refund process or its compliance with the court order.

HMT export payments eligible for refund included those made by plaintiffs starting two years prior to their first filing with the CIT to recover such payments. The scope of our review focused principally on (1) Customs' responsibilities regarding HMT export refunds, and (2) the related procedural criteria specified in the CIT's court order. We did not focus our review efforts on actions required by Justice or the plaintiffs. We considered those entities to be outside the scope of our review. We did, however, include the work performed by the contractor Customs hired to (1) help develop and implement refund procedures, and (2) process claims. We did not include the contractor's close-out review of the claim files because that review had no bearing on the refund process.

We conducted our fieldwork during May 1999; however, we updated our report, where applicable, to reflect activity that occurred through the September 1999 reporting period. We conducted our fieldwork at Customs' Accounting Services Division and at an off-site facility rented by Customs, both located in Indianapolis, Indiana.

To accomplish our review objectives, we: (1) met with Customs and contractor personnel involved in the refund process; (2) reviewed

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<sup>5</sup>We considered the temporary personnel hired by the contractor to be "contractor personnel" and refer to them as such throughout the report.

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pertinent background information including, but not limited to, applicable court filings and decisions, related HMT statutes, monthly status reports for November 1998 through September 1999, and Customs' refund procedures; (3) conducted walk-throughs of Customs' refund and payment processes; and (4) tested a sample of paid refunds.

For our sampled refunds, we (a) judgmentally selected all (80) paid claims greater than \$1 million, (b) randomly selected 22 paid claims under \$1 million, and (c) judgmentally selected the eleven oldest claims greater than \$100,000, excluding those already selected using the two prior sampling methodologies. We discarded one sample selection of more than \$1 million because it was a court test case; thus, it was not processed under the same procedures as the other 112 claims. However, our review determined that the claim and payment for that case was valid. In total, we reviewed 112 paid claims totaling \$267 million (or 68 percent) of the \$391 million (1,076 paid claims) refunded as of April 26, 1999.

We also tested the requirement that Customs was to issue a revised payment report and certification form, under Phase II, within 60 days of March 15, 1999 (the start of the Phase II process), to plaintiffs who disputed the amount determined by Customs to be refunded under Phase I. This test covered all (103) Phase II payment report and certification forms issued as of May 18, 1999. Payment report and certification forms were the means by which Customs communicated to plaintiffs the amount of proposed refund. In addition, we had the contractor test all (1,201) claims totaling \$420 million paid as of May 4, 1999, to determine whether the claims were processed and paid within 30 days of the court entering judgment.

We conducted our review in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States, and included such tests and inquiries considered necessary.

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## **Audit Results**

### **Finding 1**      **Customs' Harbor Maintenance Tax Refund Procedures Were Adequate**

Our review disclosed that, overall, Customs had put in place adequate procedures related to refunds of HMT on exports. Customs accomplished this in part by hiring a contractor to (1) help develop and implement refund procedures, and (2) process claims. In addition, Customs limited the payment process of export HMT refund claims to certain employees.

#### **Customs' Contractor Developed a Stand-Alone HMT Database to Process Claims**

The contractor developed a unique, stand-alone HMT database to process claims. Before developing the database, the contractor assessed the quality of Customs' HMT data. The contractor then used the results of its assessment to develop the HMT database. Initial input of data into the database came from downloaded data from Customs' Harbor Maintenance Fee Module (HMT collection data) and Refund Module, which contained HMT refund data. Customs provided periodic updated HMT data to the contractor.

The HMT database structure allowed contractor personnel to: (1) perform in-depth searches to locate HMT export payments eligible for refund; (2) identify prior refunds of such payments; (3) image documents received from the plaintiffs; and (4) generate letters to plaintiffs confirming the receipt of initial claim forms, as well as disputed payment report and certification forms. In addition, the database provided audit trails of database searches performed by claim processors and quality control reviewers.

#### **Additional Procedures Were Implemented to Guard Against Erroneous Refunds and Overpayments**

Customs, in concert with its contractor, implemented additional procedures to guard against erroneous refunds and overpayments. These procedures included searching original documents when the



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search of the HMT database did not resolve instances where the recorded total export fees did not equal the total check amount(s).

Refunds were based on total fees recorded instead of total amounts paid because a one-for-one correlation did not always exist between the HMT fee due and the check amount. For example, some exporters paid a quarterly HMT with multiple checks. In these instances, a separate transaction was recorded for each check, but the total fee was not allocated to each check received. The total fee was associated with the first check recorded. Also, a freight forwarder, who ships goods for others, typically would submit one check to cover the HMT fees for several exporters. In those instances, the total fees due for a particular exporter would not equal the check amount. In these types of situations, additional research of the HMT database, including some paper document searches, was done. However, the additional searches did not significantly impact the overall processing of claims.

In addition, Customs performed a "clean-up" of HMT payments received as cash receipts at its Accounting Services Division versus receipt of such payments at the lockbox bank. In this effort, Customs created a separate file to record such payments because the information could not be added to the export user fee file created by the lockbox bank. This effort included ensuring that those payments were posted to the correct collection classification code. The contractor included this file in the HMT database.

Also, Customs advised the contractor not to include, on the payment report and certification form, any payments after April 25, 1998. Customs stopped collecting HMT on exports after that date. HMT export payments received by Customs after that date were refunded separately from the court-ordered refund process.

We noted that Customs inadvertently overpaid, in total, \$150,000 on 12 of 2,891 court-approved judgments (\$689 million) paid as of September 10, 1999. Processing errors by lockbox bank personnel, at the time of initial receipt of the HMT payments, accounted for eight overpayments. Specifically, bank personnel incorrectly coded some non-export HMT payments as export HMT payments. Processing errors by contractor personnel, during the refund process,

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accounted for four overpayments. Contractor errors included incorrect court filing dates input to the HMT database.

Two of the 12 overpayments were included in our sample of paid judgments. The contractor identified one of these two overpayments prior to providing the files for our review. We identified the other overpayment. The contractor identified eight other overpayments from its close-out review of the claim files that began in May 1999 and continued until its principal involvement with the refund process ended on July 15, 1999. In September 1999, Customs identified two additional overpayments.

One aspect of the close-out review focused on HMT export payments not eligible for refund. Ineligible payments included payments made before the two-year statute of limitations period. For example, if a plaintiff filed a court action on May 1, 1995, then any payments made before May 1, 1993, would not be eligible for refund. As stated earlier, also ineligible for refund under the court-ordered refund process were payments received by Customs after April 25, 1998.

In each overpayment instance, Customs notified Justice. Justice has the responsibility to determine whether to seek recovery of the overpayments. As of September 10, 1999, one overpayment of \$292 had been recovered from one of the plaintiffs.

### **Proper Separation of Duties Existed**

Our walk-throughs of Customs' refund and payment processes showed that proper separation of duties existed. Contractor personnel did not have access to the payment module in Customs' Asset Management Information System. Likewise, the Customs employees assigned to process refunds for payment did not have access to the HMT database. Within both groups, further separation of duties existed. For example, contractor personnel designated as initial claim processors did not have access to the HMT database functions reserved for quality control reviewers, and vice versa. Also, the Customs employee who approved refunds for payment did not have access to the input module, while the employees who had input capabilities did not have access to the payment module.

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To test this control, we had some of the contractor personnel and Customs employees attempt to perform functions not assigned to them. In each instance, each system denied the individuals access to functions they did not have in his or her individual system profile.

**Finding 2**      **No Significant Instances of Non-Compliance with the Court of International Trade's Court Order Were Identified**

Our review did not disclose significant instances of non-compliance with the CIT's court order. The adequacy of Customs' refund procedures, as discussed in Finding 1, contributed largely to Customs' general compliance with the court order. Efforts by Customs and its contractor resulted in Customs: (1) meeting, generally, the requirement to process claims received by October 15, 1998, as required; (2) meeting the CIT's status report issuance timeframe; and (3) exceeding the requirement to process at least 500 claims per month after December 15, 1998. In addition, only minor exceptions occurred regarding the processing timeframes for issuing revised payment report and certification forms and processing court-approved judgments for payment.

The court order required Customs to process claim forms received by October 15, 1998, in chronological order by date of filing of plaintiff's first complaint. The contractor generally processed those claims as required by the court order. Some deviation occurred when multiple plaintiffs filed multiple claim forms using the same exporter name and Employer Identification Number. In those instances, the contractor combined the claim forms and processed them simultaneously as one claim.

In addition, Customs was to process claim forms received after October 15, 1998, in order of receipt of the claim form. However, only one such claim, which we included in our sample of paid judgments, had been processed and paid at the time of our fieldwork. Therefore, we do not comment on whether other such claims were processed as required.

The court order required Customs to report monthly on its claims processing progress to the CIT. The first status report was due November 15, 1998, and on the 15th of every month thereafter.

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Customs sent monthly processing results to Justice, who forwarded the reports to the CIT. Our review of the status reports for November 1998 through September 1999, showed that Customs, in concert with Justice, issued monthly status reports timely.

The September 1999 status report, related attachments, and other data showed Customs' cumulative progress with respect to claims received by October 15, 1998. Customs had received 3,248 such claims (including 35 duplicates) and issued 3,185 payment report and certification forms, which listed payments eligible for refund. Of those, the CIT received 2,803 proposed judgments and, of that number, approved 2,774 of them totaling \$683.3 million. Of the approved judgments, 2,745 of them totaling \$681.7 million had been paid as of September 10, 1999.

The same information used above showed Customs' cumulative progress with respect to claims received after October 15, 1998. Customs had received 224 such claims (including 1 duplicate) and issued 216 payment report and certification forms. Of those, the CIT received 158 proposed judgments and, of that number, approved 148 of them totaling \$7,046,000. Of the approved judgments, only one (\$2.8 million) had been paid and included in our sample of paid judgments we selected in May 1999. The remaining 147 claims (\$4.2 million) were paid in July-September 1999.

The court order also required Customs to process no fewer than 500 claims per month after December 15, 1998. Review of status reports for January 1999 through May 1999 showed that Customs exceeded the requirement to process at least 500 claims per month. The May 1999 status report showed that Customs had processed 91 percent (3,090/3,409) of the claims received. Comparisons of the May through September 1999 status reports showed that Customs had received only 27 new claims since the May reporting period.

Lastly, with minor exceptions, Customs met the court-ordered processing timeframes related to revised payment report and certification forms and court-approved judgments. We conducted tests to determine whether Customs (1) issued revised payment report and certification forms within 60 days, and (2) processed court-approved judgments for payment within 30 days. We tested all (103)

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revised payment report and certification forms issued as of May 18, 1999. In addition, we had the contractor test all (1,201) entered judgments paid as of May 4, 1999.

In each test, we identified one instance where the processing timeframe was not met. In one instance, a Phase II claim processor did not forward timely for review, and mailing to the plaintiff, a revised payment report and certification form. The 60-day timeframe had expired by three days by the time the error surfaced and corrective action was taken.

In another instance, Customs inadvertently tried to process a single check for more than \$1 million. Treasury's Financial Management Service (FMS), which issues checks for the Government, cannot process a single payment for \$1 million or more. Therefore, any payment that equals or exceeds \$1 million requires multiple checks. The 30-day timeframe had expired by four days by the time Customs re-processed the rejected payment and FMS issued multiple checks. We noted no other processing timeframe exceptions attributable to the contractor or Customs, respectively.

## ABBREVIATIONS

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CIT	U.S. Court of International Trade
FMS	Financial Management Service, U.S. Treasury
Government	U.S. Government
HMT	Harbor Maintenance Tax
Justice	U.S. Department of Justice
U.S.	United States

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